

Office of Chief Counsel
Internal Revenue Service
Memorandum

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Third Party Communication: None
Date of Communication: Not Applicable

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date: May 12, 2008

to: Julie Garcia, Director
Office of Stakeholder, Partnerships, Education and Communication (SPEC)

from: Michael J. Montemurro
Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)

subject: Non-imposition of Early Termination Charges under the Servicemembers Civil Relief Act

You have inquired whether lessors of motor vehicles (Lessors) are required to issue Forms 1099-C, *Cancellation of Debt*, when members of the military exercise their option under the Servicemembers Civil Relief Act to terminate a motor vehicle lease. This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

Section 61(a) of the Internal Revenue Code provides that gross income includes all income from whatever source derived, including income from discharge of indebtedness. See § 61(a)(12). In addition, if a taxpayer is released from an obligation to pay under the terms of an instrument that imposed the obligation to pay, the taxpayer realizes an accession of wealth, and thus income, although it is not income from discharge of indebtedness. See *United States v. Centennial Savings Bank FSB*, 499 U.S. 573 (1991).

Section 6050P requires that any applicable entity that discharges (in whole or in part) the indebtedness of any person during any calendar year shall make a return setting forth certain information including the name, address, and TIN of each person whose indebtedness was discharged during such calendar year, the date of the discharge, and the amount of the indebtedness discharged. This information is provided on a Form 1099-C, *Cancellation of Debt*.

It is our understanding that generally a motor vehicle lease requires lessees who terminate the lease early to pay an "Early Termination Charge." You have inquired as to the tax treatment of this Early Termination Charge with respect to termination of motor vehicle leases by members of the military under the Servicemembers Civil Relief Act.

Section 305(a) of the Servicemembers Civil Relief Act (SCRA), Pub. L. No. 108-189, 117 Stat. 2848, 50 U.S.C. app. § 535, allows a lessee on a lease described in section 305(b) of a motor vehicle to terminate the lease at any time after (i) the lessee's entry into military service or (ii) the date of the lessee's military orders described in section 305(b)(2)(B). For example, if a lessee, while in military service, executes a motor vehicle lease and thereafter receives military orders to deploy with a military unit, for a period of not less than 180 days, the lessee may terminate the lease. Under the SCRA, the rents or lease amounts unpaid for the period preceding the effective date of the lease termination must be paid on a prorated basis. However, the SCRA also specifically provides that in the case of a motor vehicle lease, a lessor may not impose an early termination charge.¹

Thus, if a member of the military (Servicemember) exercises his or her option to terminate a motor vehicle lease in accordance with the SCRA, then the Lessor cannot impose an Early Termination Charge. Because the Lessor cannot impose the Early Termination Charge on the Servicemember under the SCRA in the first instance, the Servicemember owes nothing to the Lessor due to the early termination of the motor vehicle lease. Consequently, Servicemembers who exercise their option under the SCRA to terminate a motor vehicle lease early do not have discharge of indebtedness income under § 61(a)(12) or any other form of income with respect to the Early Termination Charge they are not required to pay. Therefore, applicable entities should not issue Forms 1099-C in these circumstances.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4920 if you have any further questions.

¹ Section 305(e) of the SCRA, 50 U.S.C. app. § 535(e) states: Rents or lease amounts unpaid for the period preceding the effective date of the lease termination shall be paid on a prorated basis. In the case of a lease of a motor vehicle lease, *the lessor may not impose an early termination charge*, but any taxes, summonses, and title and registration fees and any other obligation, and liability of the lessee in accordance with the terms of the lease, including reasonable charges to the lessee for excess wear, use and mileage, that are due and unpaid at the time of termination of the lease shall be paid by the lessee. [Italics added.]